MINISTER OF FINANCE APPOINTS NEW SUPERINTENDENT 1

PART XIII OF THE *INSURANCE COMPANIES ACT* 2

COMING INTO FORCE OF BILL C-25 4

ISSUE 3 | VOLUME 1 | SEPTEMBER 2007

OSFI BSIF

FROM THE OFFICE OF THE SUPERINTENDENT OF FINANCIAL INSTITUTIONS CANADA (OSFI)

Pillar

New Superintendent appointed

The Honourable Jim Flaherty, Minister of Finance, announced on July 4, 2007, the appointment of Julie Dickson as Superintendent of Financial Institutions for a seven-year term.

"I am pleased Ms. Dickson has agreed to serve in this role to promote the stability and soundness of Canada's financial system, in the best interest of all Canadians," said Minister Flaherty.

Ms. Dickson, who most recently served as Deputy and then Acting Superintendent, has more than 25 years' experience in the financial services field in both the public and private sectors. She worked for 15 years with the Department of Finance, primarily in areas related to financial sector policy.

Ms. Dickson joined OSFI in April 1999, and was Assistant Superintendent, Regulation Sector, from January 1, 2000, to June 2006. She was named Deputy Superintendent in June 2006 and Acting Superintendent in October 2006.

Superintendent Julie Dickson

"I look forward to the opportunity to build on the efforts of my predecessors," said Ms. Dickson, "and to help maintain a safe and sound financial system that Canadians can continue to have confidence in."

Recent financial market events

Events in global credit markets in the last few months have led to much discussion in Canada and internationally. Rising default rates on sub-prime mortgages in the United States were the trigger for the turmoil in financial markets. This was amplified when globally, investors focussed on potential losses in an environment where there was uncertainty about the types of loans underlying assets that they had purchased, such as asset-backed commercial paper (ABCP). That led to markets for ABCP to become very illiquid, with many ABCP vehicles having difficulty selling paper to investors.

A situation unique to Canada was the prominence of a particular type of liquidity line. While banks around the world often provide liquidity lines to ABCP vehicles, the conditions under which liquidity is provided varies. In this regard, there were generally two types of liquidity lines provided by banks: those that provide liquidity in the event of general market disruption (which attract no capital requirement, as per international Basel capital requirements); and those that provide liquidity where an individual conduit experiences difficulty rolling over asset-backed commercial paper (called "global style" liquidity lines, which attract a credit conversion factor of 10%, as per international Basel capital requirements).

Continued on page 2

Continued from page 1 — Canadian banks provided both types of lines, but in Canada, market disruption lines comprised the majority. The large Canadian banks have recently announced that they would convert any general market disruption lines to global style lines. OSFI agrees that this is desirable, especially given that recent events demonstrate that the risks to banks associated with general market disruption liquidity facilities are similar to global style liquidity facilities. We also note that, under the Basel II accord, a minimum 20% credit conversion factor will apply to such liquidity facilities beginning in 2008.

Canada's banking system is well capitalized and was not materially affected by recent events. Still, OSFI will be working with its regulatory partners in Canada, and internationally, to see what lessons learned here can be applied going forward.

Part XIII of the *Insurance Companies Act*

In May 2007, OSFI issued a letter to the insurance industry outlining the steps it proposes to take to implement the amendments to Part XIII of the *Insurance Companies Act* contained in *An Act to amend the law governing financial institutions and to provide for related and consequential amendments*, S.C. 2007, c. 6. The amendments to Part XIII clarify the regulatory scope that applies to Canadian branches of foreign insurance companies. OSFI recommended to the Department of Finance that the amendments to Part XIII come into force on January 1, 2009.

Following the coming into force of the amendments to Part XIII, risks located in Canada but insured outside Canada by foreign companies will no longer be subject to Part XIII requirements (including reporting and vesting requirements); and risks located outside Canada but insured in Canada will become subject to Part XIII requirements. In order to ease the transition for OSFI and foreign companies, in respect of the first scenario outlined above, OSFI will presume all risks reported on the books of a branch as at January 1, 2009, to have been insured in Canada and therefore subject to Part XIII requirements, unless the foreign company satisfies OSFI – or OSFI otherwise comes to the view – that some or all of those risks were insured outside Canada.

In respect of the second scenario outlined above, OSFI expects that foreign companies will, within a reasonable timeframe after the coming into force of the amendments to Part XIII, use their best efforts to identify all the risks located outside Canada that were insured in Canada prior to January 1, 2009 and comply with Part XIII requirements in respect of those risks. This approach is consistent with the *Winding-up and Restructuring Act* and the nature of the clarifications brought to Part XIII. Following the coming into force of the amendments to Part XIII, some foreign companies may have an excess of vested assets in relation to the risks they insured in Canada. Foreign companies will be able to seek a release of vested assets held in respect of risks they prove to OSFI were insured outside Canada, so long as they demonstrate that, following the release, they will hold sufficient vested assets in Canada for all the risks they insured in Canada regardless of the location of such risks.

To assist foreign companies in determining where a risk was insured, OSFI will issue its Advisory entitled "Insurance in Canada of risks" in its final form in the near future. For additional information or if you have any questions regarding the contents of this letter, please contact Philipe Sarrazin, Director, Legislation and Policy Initiatives by email at philipe.sarrazin@osfi-bsif.gc.ca.

To view the complete document, visit the OSFI Web site at: www.osfi-bsif.gc.ca

OSFI Superintendent announces new executive member

Asst. Superintendent
Bob Hanna

On August 8, 2007, Superintendent of Financial Institutions Julie Dickson, announced the appointment of Bob Hanna as Assistant Superintendent, Regulation Sector.

Mr. Hanna had been acting in the role since October 2006 when he replaced Ms. Dickson, who had been appointed Acting Superintendent at that time. Ms. Dickson was subsequently named Superintendent in July 2007.

OSFI's Regulation Sector is responsible for enhancing the financial system's safety and soundness by evaluating system-wide risks, and promoting sound business and financial practices.

To view the complete text of the announcement, visit the OSFI Web site at: www.osfi-bsif.gc.ca

Location and processing of information and data

In the context of the Government of Canada's regular five-year review of the federal financial institutions legislation, various provisions of *An Act to amend the law governing financial institutions and to provide for related and consequential amendments*, S.C. 2007, c. 6 (formerly Bill C-37) were proclaimed in force on April 20, 2007.

In particular, the Act removed the need for a federally regulated entity to obtain the approval of the Superintendent, known as a "data processing order", to maintain and process outside Canada information or data relating to the preparation and maintenance of certain corporate, accounting and customer records. However, the Superintendent may direct the entity to not maintain or process information or data in another country, or to maintain or process information or data in Canada, if the Superintendent is of the opinion that the maintenance or processing of the information or data outside Canada is incompatible with the fulfillment of OSFI's responsibilities. No changes have been made in respect of the legislative requirement that financial institutions must maintain in Canada certain corporate, accounting and customer records.

With respect to terms and conditions contained in data processing orders granted prior to April 20, 2007, and undertakings provided in consideration for the granting of such orders, OSFI is of the view that while the repeal of the approval requirements has released the federally regulated entities and their service providers from these terms, conditions and undertakings, OSFI expects that federally regulated entities will ensure that their material data processing outside Canada is in compliance with the risk management expectations contained in Guideline B-10 Outsourcing of Business Activities, Functions and Processes.

In the coming months, Guideline B-10 will be reviewed and revised to reflect the removal of the restrictions on information and data processing outside Canada. In the interim, OSFI expects that federally regulated entities will continue to ensure that OSFI has access to data and information relating to the preparation and maintenance of certain corporate, accounting and customer records that are maintained or processed outside Canada. OSFI will consult with the industry if other significant changes are proposed as a result of this review.

If you have questions regarding the above, please contact Emiel van der Velden at emiel.vandervelden@osfi-bsif.gc.ca.

To view the complete document, visit the OSFI Web site at: www.osfi-bsif.gc.ca

Innovative Tier 1 and other capital clarifications

OSFI has released an update to the Advisory Innovative Tier 1 and Other Capital Clarifications – Revised Version, issued in December 2006.

There are four main areas where revisions have been made:

Certain conditions in Section 5 have been revised to include additional detail on the limited inclusion of subordinated debt issued by non-consolidated financing entities in Tier 2B capital:

- Condition 3, which discusses the level of subordination of the external financing instrument in liquidation and provides guidance on the term to maturity for the associated inter-company securities;
- Condition 7, which includes a requirement for clarity in the notes to the consolidated financial statements with respect to the subordination in liquidation of the instrument appearing on the balance sheet of the regulated entity;
- Condition 10, which provides guidance on a permissible level of assets that may be held by the financing entity in cases where acceptable conversion or exchange features are appropriately incorporated into the financing structure.

Section 6 has been expanded to provide detailed criteria that OSFI will consider when reviewing a FRE proposal for consolidated capital recognition of an instrument that is counted in a particular capital tier by a recognized foreign regulator. Appendix B has been added to outline the considerations used by OSFI to assess Real Estate Investment Trust preferred shares issued by a wholly-owned subsidiary of a foreign regulated bank.

Section 7 has been added to provide OSFI's assessment of "make-whole" provisions in Tier 2 capital.

Section 8 has been included to discuss OSFI's position with respect to events of default, in relation to Tier 2A-qualifying debentures, that occur only after the event that triggered a deemed conversion to shares has taken place.

This Advisory, which replaces the December 2006 version, came into effect in June 2007.

To view the complete update, visit the OSFI Web site at: www.osfi-bsif.gc.ca

Coming into force of Bill C-25

On June 27, 2007, an Order in Council bringing into force certain amendments to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (PCMLTFA) and Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations (PCMLTFR) was published in the Canada Gazette. These amendments set out important changes to the PCMLTFA and the PCMLTFR that will affect the AML/ATF regimes of federally regulated financial institutions.

The regulatory changes, coupled with OSFI's accumulated experience in assessing financial institutions' AML/ATF risk management and compliance controls, have prompted the Office to review its expectations for the federally regulated financial sector going forward.

The new regulations represent a significant milestone in the development of Canada's AML/ATF regime. OSFI will be taking these new measures into account when assessing financial institutions' AML/ATF compliance and risk management programs. It is OSFI's expectation that financial institutions will be assessing the need for changes to their policies and procedures in order to address the new requirements. During the assessment of financial institutions' compliance and risk management regimes, OSFI will be making enquiries with respect to action plans and timelines to meet the new standards.

The PCMLTFA sets out a framework for financial institutions' AML/ATF regimes; however, many of the changes to the PCMLTFA and regulations are designed to permit financial institutions to apply a risk-based approach to the implementation of their AML/ATF programs. This permits financial institutions to exercise reasonable business judgement with respect to their money laundering and/or terrorist financing risk, and enables them to apply resources so that the higher risks receive an appropriate level of mitigation.

For additional information or any enquires, please contact OSFI's Compliance Division.

To view the complete text of this document, visit the OSFI Web site at: www.osfi-bsif.gc.ca

Chief Actuary of Canada unveils peer review panel

On September 6, 2007, the Office of the Chief Actuary (OCA) announced the establishment of a panel of actuaries to review the 23rd Actuarial Report on the Canada Pension Plan (CPP).

Produced every three years, the Actuarial Report on the CPP is considered by the federal and provincial ministers of Finance when reviewing and making recommendations on the CPP. The external peer review process was first introduced in January 1999.

The panel members have all been very active in the Canadian Institute of Actuaries (CIA) and are Fellows. The panel comprises Mr. Mark Campbell, a member of the CIA Actuarial Standards Board and previous reviewer of the CPP Actuarial Report, who will serve as chairman of the panel; Mr. Patrick F. Flanagan, a director of the Board of the CIA; and Mr. Thomas D. Levy, currently vice-chairperson, Practice (Standards) Council of the CIA. Each member has extensive experience in pension plan actuarial valuation.

Parliamentary tabling of the Actuarial Report is expected to take place before year end. The panel will then have three months to perform the review, and prepare a report.

To view the complete text of the release, visit the OSFI Web site at: www.osfi-bsif.gc.ca

SUBSCRIBER NOTIFICATION

Would you like to be notified when notices or items of interest are posted to the OSFI Web site? Then on your next visit to our site, sign up for notifications at the Subscription Centre located on the home page.

Just select your areas of interest, and when something is posted in that area, you will receive an email with a link to the relevant information.

The OSFI *Pillar*

The *Pillar* is published by the Communications and Public Affairs Division of the Office of the Superintendent of Financial Institutions Canada.

For a free subscription, or to provide feedback, please e-mail OSFI Communications and Public Affairs at: thepillar@osfi-bsif.gc.ca

OSFI BSIF

255 Albert Street
Ottawa, Ontario K1A 0H2